Report to Cabinet

Subject: Annual Treasury Activity Report 2020/21

Date: 8 July 2021

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Wards Affected

All

Purpose

To inform Members of the outturn in respect of the 2020/21 Prudential Code Indicators, and to advise Members of the outturn on treasury activity, both as required by the Council's Treasury Management Strategy.

Key Decision

This is not a key decision.

Recommendation:

That:

1. Members approve the Annual Treasury Activity Report for 2020/21 and refer it to Full Council for approval, as required by the regulations.

1 Background

1.1 The Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury review of its activities, and the actual Prudential and Treasury Indicators for 2020/21. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

1.2 For 2020/21 the minimum reporting requirements were that the Full Council should receive the following reports:

- An Annual Treasury Management Strategy Statement (TMSS) in advance of the year. This was considered by Cabinet on 13 February 2020 and subsequently approved by Full Council on 5 March 2020.

- A Mid-Year Treasury Update report. In accordance with best practice, Members will note that, as in previous years, quarterly monitoring reports for treasury activity have been provided, and that this exceeds the minimum requirements.

- An Annual Review following the end of the year describing the activity compared to the strategy. This report is in fulfilment of this requirement.

1.3 The regulatory environment places responsibility on Members for the review and scrutiny of treasury management policy and activities. The Annual Treasury Activity Report provides details of the outturn position for treasury activities during the year, and highlights compliance with the Council's policies, previously approved by Members.

1.4 The Council has complied with the requirement under the Code to give prior scrutiny to all the above treasury management reports by submitting them to Cabinet before they are reported to Full Council.

1.5 Member training on treasury management issues is undertaken by the Chief Financial Officer as it is needed in order to support Members' scrutiny role. In addition, the Council's treasury advisers, Link Asset Services (LAS) periodically deliver more detailed training sessions for Members at the request of the Chief Financial Officer.

2 Proposal

2.1 <u>Summary of the economy and interest rates during 2020/21</u>

2.1.1 The year 2020/21 will for ever be known as the year of the coronavirus pandemic. The first national lockdown in late March 2020 did huge damage to the economy and caused a downturn that exceeded that caused by the financial crisis of 2008/09. A short second lockdown in November did relatively little damage, and by the time of the third lockdown in January 2021, businesses and individuals had become more resilient to working in new ways. The successful UK vaccination programme has been instrumental in speeding economic recovery and the reopening of the economy. The household saving rate has been exceptionally high and there is much pent up demand, leading to an expectation that the UK economy could recover its pre-pandemic level of activity during Q1 of 2022. Both the government and the Bank of England

(BOE) took rapid action at the height of the crisis to provide support to financial markets to ensure their proper functioning; to support the economy; and to protect jobs.

2.1.2 The Monetary Policy Committee (MPC) cut Bank Rate from 0.75% to 0.25% on 11 March 2020, and then to 0.1% on 19 March 2020, and embarked on a £200bn programme of quantitative easing (QE). Bank Rate remained unchanged throughout 2020/21, however at one point there was concern in the financial markets that the MPC might cut Bank Rate to a negative rate. This was firmly discounted at the February 2021 MPC meeting when it was established that commercial banks would be unable to implement negative rates for at least six months – by which time the economy was expected to be making a strong recovery and negative rates would no longer be needed.

2.1.3 The MPC adopted a major change in its implementation of the 2% inflation target during 2020/21, indicating that it did not intend to tighten monetary policy "until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% target sustainably". Essentially this means that even if inflation rises to 2% the MPC is unlikely to act unless it considers that it will be persistently so.

2.1.4 The Chancellor implemented repeated rounds of support to businesses, and protected jobs by the use of the furlough scheme, however this support has come at a huge cost. The budget on 3 March 2021 increased fiscal support to the economy and jobs during 2021 but also pointed to substantial tax rises in the following three years to help to pay for the cost of the pandemic. An area of concern is that the Government's debt is now twice as sensitive to interest rate rises as before the pandemic due to QE operations substituting fixed for variable rate debt. There is thus more incentive for the Government promoting low rates by using fiscal policy in conjunction with monetary policy action by the MPC to keep inflation from rising too high.

2.1.5 The final Brexit trade agreement on 24 December 2020 eliminated a significant downside risk for the UK economy. However, the initial agreement covered only trade so there remains work to be done on the services sector, where a temporary equivalence has been granted in both directions – and still needs to be made permanent. There was significant disruption to trade in January 2021 but this seems to have eased.

2.1.6 The EU economy rebounded rapidly after the first lockdowns in 2020, but then contracted slightly. Both the rollout and uptake of vaccines has been disappointingly slow in the EU and it is expected that economic recovery will be delayed until Q3 of 2021, with a return to pre-pandemic levels expected in the second half of 2022.

2.2 The Council's overall Treasury position at 31 March 2021

The Council's debt and investment position is organised to ensure adequate liquidity for revenue and capital activities, security of investment, and to manage risks within all treasury management activities. At the beginning and end of 2020/21, the treasury position was as follows:

Treasury position:	1 April 2020 £000s	31 March 2021 £000s
Total external debt	9,812	9,812
Capital Financing Requirement (CFR)	10,313	10,013
Over/(under) borrowing to CFR	**(501)**	**(201)**
Total external debt	9,812	9,812
Total investments	(14,150)	(17,885)
Net debt/(investment)	**(4,338)**	**(8,073)**

Full details of the Council's borrowing and investments can be found at Appendix 1.

2.3 The Treasury Strategy for 2020/21

2.3.1 The expectation within the treasury strategy for 2020/21 (the TMSS) was that whilst uncertainty would remain, a Brexit deal would eventually be agreed, including the terms of trade between the UK and the European Union, by the deadline of 31 December 2020. Bank Rate was not expected to rise from 0.75% until March 2021. A further rise was not expected until June 2022, however it was noted that due to uncertainty in the markets, exceptional levels of volatility might prevail. Investment rates were expected to remain low during the year, and to be on only a gently rising trend over the following years. The treasury strategy was therefore to maintain an under-borrowed position, ie. postpone borrowing to avoid the cost of holding higher levels of investments at rates lower than the cost of the borrowing. It was however noted that some borrowing would be inevitable to support the planned commercial investment programme, and that care would be needed to ensure that borrowing was not postponed to a point where undertaking it at higher rates would be unavoidable.

2.3.2 In the event, world economic conditions fundamentally changed in March 2020 with the declaration of the coronavirus pandemic. In the face of this emergency the MPC announced a cut in Bank Rate to 0.25% on 11 March, and a further cut to 0.10% on 19 March. This rate remains in force.

2.4 The Council's Borrowing Requirement

The Council's underlying need to borrow for capital expenditure is termed the capital financing requirement (CFR), and is a gauge of the Council's indebtedness.

The CFR results from the Council's capital activity, and the resources it uses to pay for that capital spending, and represents unfinanced expenditure that has not yet been paid for from revenue or other resources.

CFR:	1 April 2020 (Actual) £000s	31 March 2021 (Orig. Est-TMSS) £000s	31 March 2021 (Actual) £000s
Capital Financing Requirement	10,313	17,354	10,013

The significant 2020/21 variance on the CFR is due to deferrals and savings on the 2019/20 capital programme, both of which reduced the borrowing requirement in that year, and to amendments on the capital programme during 2020/21, including the deferral of schemes to 2021/22.

The Council had previously embarked upon a commercialisation programme aimed at the generation of funds to replace Revenue Support Grant, which was withdrawn at the end of 2018/19. Significant additional borrowing was anticipated to support this commercial programme, and CFR was expected to rise significantly. Following HMT's conclusion on the use of PWLB borrowing that such borrowing would be prohibited for all capital programmes that included any investment schemes primarily for yield, even if these represented only a small part of the programme, Cabinet agreed on 28 January 2021 to withdraw the Commercial Property Investment Strategy (CPIS) and to remove the £5m budget from the Capital programme. For full details see 2.10.2 below.

2.5 Borrowing rates in 2020/21

Medium and longer term fixed borrowing rates were expected to rise only gradually during 2020/21 and the two subsequent financial years.

Variable or short term rates were expected to be the cheaper form of borrowing over the period.

The following projections were provided by the Council's treasury advisers as at 31 January 2020 and were reported in the TMSS for 2020/21.

Link Asset Services Interest Rate View	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Bank Rate View	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.25	1.25	1.25	1.25
3 Month LIBID	0.70	0.70	0.70	0.80	0.90	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.30	1.30
6 Month LIBID	0.80	0.80	0.80	0.90	1.00	1.10	1.10	1.20	1.30	1.40	1.50	1.50	1.50	1.50
12 Month LIBID	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.40	1.50	1.60	1.70	1.70	1.70	1.70
5yr PWLB Rate	2.30	2.40	2.40	2.50	2.50	2.60	2.70	2.80	2.90	2.90	3.00	3.10	3.20	3.20
10yr PWLB Rate	2.60	2.70	2.70	2.70	2.80	2.90	3.00	3.10	3.20	3.20	3.30	3.30	3.40	3.50
25yr PWLB Rate	3.20	3.30	3.40	3.40	3.50	3.60	3.70	3.70	3.80	3.90	4.00	4.00	4.10	4.10
50yr PWLB Rate	3.10	3.20	3.30	3.30	3.40	3.50	3.60	3.60	3.70	3.80	3.90	3.90	4.00	4.00

PWLB rates are based on, and determined by, UK Government Bond (gilts) yields plus a specified margin determined by HM Treasury. It is anticipated that there will be only a gentle rise in gilt yields and PWLB rates over the next three years as Bank Rate is not expected to rise from 0.1% before March 2024.

For illustration, the table below shows the LAS forecasts for interest rates as at 8 March 2021.

Link Group Interest Rate View 8.3.21	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
BANK RATE	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
6 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
12 month ave earnings	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
5 yr PWLB	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.30	1.30	1.40	1.40	1.40	1.40
10 yr PWLB	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.80	1.80	1.90	1.90	1.90	1.90
25 yr PWLB	2.10	2.10	2.10	2.20	2.30	2.30	2.30	2.40	2.40	2.50	2.50	2.50	2.50
50 yr PWLB	1.90	1.90	1.90	2.00	2.10	2.10	2.10	2.20	2.20	2.30	2.30	2.30	2.30

2.6 The Council's borrowing outturn for 2020/21

2.6.1 No new borrowing was undertaken during 2020/21 and no loans were redeemed during the year.

As noted at 2.4 above, the Council had previously embarked upon a commercialisation programme for which significant additional borrowing was anticipated. As a result of the withdrawal of the Commercial Property Investment Strategy, following HMT's conclusion that PWLB borrowing would be prohibited for all capital programmes that included any investment schemes primarily for yield, no new borrowing was required for commercial property purchases in 2020/21 (see 2.10.2 below).

2.6.2 The Council did not borrow more than, or in advance of its needs, purely to profit from the investment of the extra sums borrowed, and will not do so.

2.6.3 Total outstanding debt at 31 March 2021 was £9.812m. All loans held are repayable on maturity, and are at fixed rates.

2.6.4 There was no rescheduling of PWLB debt undertaken during the year, as the significant differential between PWLB new borrowing rates and premature repayment rates made such action unviable.

2.6.5 No temporary borrowing was arranged for cashflow purposes during 2020/21.

2.7 Investment rates in 2020/21

Continued uncertainty in the aftermath of the 2008 financial crisis promoted a cautious approach to investment during 2020/21, and it continues to be dominated by seeking low counterparty risk - resulting in relatively low returns compared to borrowing rates. Investment returns in general were exceptionally low in 2020/21, indeed for very short-term deposits with the Debt Management Office (DMO) the rates turned negative, resulting in a small cost to place funds.

2.8 The Council's Investment outturn for 2020/21

2.8.1 The Council's investment policy is governed by MHCLG guidance and implemented by the Annual Investment Strategy, which formed part of the TMSS approved by Council on 5 March 2020. This policy sets out the approach for selecting investment counterparties. For 2020/21 the Chief Financial Officer adopted the Link Asset Services (LAS) credit rating methodology, a sophisticated modelling approach utilising credit ratings from all three of the main rating agencies to give a suggested maximum duration for investments. Accordingly it does not place undue reliance on any one agency's ratings. The methodology subsequently applies an "overlay" to take account of positive and negative credit watches and/or credit outlook information, which may increase or decrease the suggested duration of investments. It then applies a second overlay based on the

credit default swap spreads for institutions, the monitoring of which has been shown to give an early warning of likely changes in credit ratings. The methodology also incorporates sovereign ratings to ensure selection of counterparties from only the most creditworthy countries. The 2020/21 TMSS Strategy permits the use of any UK counterparties, subject to their individual credit ratings under the LAS methodology. It also permits the use of counterparties from other countries with a minimum sovereign rating of AA.

2.8.2 Whilst credit ratings advice is taken from the treasury advisers, the ultimate decision on what is prudent and manageable for the Council is taken by the Chief Financial Officer under the approved scheme of delegation.

2.8.3 No changes to the TMSS for 2020/21 approved by Council on 5 March 2020 were made during the year.

2.8.4 The Council's investment priorities in 2020/21 remained the security of capital and good liquidity. Whilst the Council always seeks to obtain the optimum return (yield) on its investments, this is at all times commensurate with proper levels of security and liquidity. During the year it remained appropriate either to keep investments short–term to cover cashflow needs, or to take advantage of fixed periods up to twelve months with a small number of selected counterparties. During the coronavirus pandemic the maintenance of liquidity has clearly been even more critical, and investment terms have been kept short.

During 2020/21, significant use was made of the Council's three Money Market Funds (MMFs). These are AAA rated investment vehicles which allow the pooling of many billions of pounds worth of assets into highly diversified funds, thus reducing risk. The equated rates of return achieved on these funds were between Nil and 0.04%, which whilst exceptionally low, remain generally higher than overnight treasury deposit rates, and the rate obtainable from the Debt Management Office (DMO), which for most durations is currently 0.01%.

2.8.5 An investment of £1m was made in the CCLA Local Authority Property Fund (LAPF) on 30 November 2017. This is a local government investment scheme approved by the Treasury under the Trustee Investments Act 1961 (section 11). The equated dividend for 2020/21 was 4.0% and this is treated as revenue income. The investment has allowed the Council to introduce a property element into its investment portfolio without the risks associated with the direct purchase of assets. The main risk around Property Funds is the preservation of the capital sum however evidence suggests that over time the property market has been a positive

long-term investment and it is accordingly anticipated that this investment will be held for at least five years to minimise any risk.

2.8.6 Notice of the suspension of the LAPF was received from CCLA in March 2020, whereby no subscriptions or redemptions could be made. Such suspension is a normal course of action in exceptional market conditions as valuers cannot be confident that their valuations truly reflect prevailing conditions, and where there is a material risk of disadvantage to either party, all transactions must be suspended until the required level of certainty is re-established. Dealing in the fund recommenced on 30 September 2020 on the basis that conditions in the property market were deemed to have stabilised. A 90-day notice period for redemptions from the fund was introduced to align the dealing terms of the fund with the liquidity of the underlying assets, and to ensure resilience during periods of market stress.

2.8.7 The property fund investment purchased a number of units, determined by the unit price on the entry date. This valued the initial investment of £1m at £936,770, setting the implied entry fee at £63,230, or 6.32%. The certified value of the property fund investment at 31 March 2021 was £929,709, reflecting a loss in value of £6,681 during the 2020/21 year. Following changes to accounting arrangements, all movements in the valuation of pooled investment funds must be charged to the Comprehensive Income and Expenditure account (CIES), however a statutory override is in place for a period of five years to ensure that the impact of these on the General Fund is neutralised. Accordingly the difference of £70,291 between the £1m investment and the certified 31 March 2021 value of £929,709 is held in the Pooled Investment Funds Adjustment Account.

2.8.8 Investment interest of £99,059 (including dividends of £39,997 on the property fund) was generated in the year, representing an equated rate of 0.43%. This outperforms the benchmark average 7 day LIBID rate, which ended the year at negative 0.07%, and in cash terms represents additional income to the General Fund of £115,200. This was achieved partly as a result of positive investment management, but was largely due to the 4.0% dividend on the Property Fund. Performance in respect of the longer average 3 month LIBID rate, which ended the year at 0.02%, still represents additional income of £94,500.

2.8.9 Investment activity during the year conformed to the approved strategy and the Council had no liquidity difficulties. Investment counterparty limits for 2020/21 were set in the TMSS at £3m, or £4m for Money Market Funds (due to them being by definition highly diversified investment vehicles). No limit is set with the Debt Management Office as this represents investment with central government. The Chief Financial Officer has

delegated authority to vary the limits as appropriate and to report any change to Cabinet at the next quarterly report. The only changes reported during 2020/21 were to limit investment in the CCLA PSDF money market fund to £3m in recognition of the pre-existing property fund investment of £1m (ie. a total of £4m with the counterparty), and to extend the limit with Santander to £4m to permit an additional 6-month investment at the preferential rate offered by the bank.

2.8.10 The Annual Treasury Activity Report for the year ended 31 March 2021 is attached at Appendix 1 in accordance with the TMSS.

2.9 Compliance with Prudential and Treasury Indicators

2.9.1 It is a statutory duty for the Council to determine and keep under review the affordable borrowing limit. The Council's approved Prudential and Treasury Indicators (affordability limits) are included in the Treasury Management Strategy Statement (TMSS) approved by Council on 5 March 2020.

2.9.2 During the financial year 2020/21 the Council has at all times operated within the Prudential and Treasury Management Indicators set out in the Council's TMSS, and in compliance with the Council's Treasury Management Practices. A summary of the outturn position at 31 March in respect of each of the 2020/21 Prudential and Treasury Management Indicators is shown at Appendix 2.

a) Prudential Indicators:

i) Capital Expenditure

The capital programme originally included both service related expenditure and commercial property investment, however, as discussed at 2.4 above, the budget of £5m for commercial investment was removed during the year following the conclusion of HMT's consultation on PWLB borrowing (see 2.10.2).

Capital expenditure for 2020/21 totalled **£2,321,750**. This differs to the approved indicator of £11,225,600 due to the inclusion of approved carry forward requests from 2019/20, and variations to the capital programme during 2020/21 which include the deferral of schemes to 2021/22 and the removal of £5m for commercial property investment referred to above.

ii) Capital Financing Requirement (CFR)

The CFR represents the Council's historic outstanding capital expenditure which has not yet been paid for from capital or revenue resources, and is

essentially a measure of the underlying borrowing need. It does not increase indefinitely since the minimum revenue provision (MRP) is a statutory annual revenue charge for the economic consumption of capital assets. The CFR totalled **£10,012,571** at 31 March 2021. This differs to the approved indicator of £17,353,900 due to savings and deferrals on the 2019/20 capital programme, as well as to variations to the capital programme for 2020/21 including the deferral of schemes to 2021/22. Again, these variations include the removal of £5m in respect of commercial property investment (see 2.10.2).

iii) Gearing ratio

The concept of gearing compares the total underlying borrowing need (the CFR) to the Council's total fixed assets, and can provide an early indication when debt levels are rising relative to long term assets held. The Council's gearing ratio at 31 March 2021 was **29%**, which is lower than the approved indicator of 37% due to the removal of the £5m budget for commercial property investment and the deferral of capital expenditure to 2021/22, but remains broadly comparable with the average gearing ratio for councils of a similar size.

iv) Ratio of Financing Costs to Net Revenue Stream – service related and commercial property

These indicators identify the trend in the cost of borrowing, net of investment income, against the net revenue stream. Financing costs represent the element of the Council's expenditure to which it is committed even before providing any services.

The outturn of **8.12%** for service related expenditure differs to the approved indicator of 18.61% due to a reduction in MRP arising from savings and deferrals on the capital programme in 2019/20; additional investment interest; and reduced direct revenue financing in 2020/21 due to the deferral of schemes to 2021/22.

The outturn in respect of commercial property is **Nil**, which differs to the approved indicator of 0.72% because no commercial investment activity was undertaken in 2019/20 and hence no MRP falls due in 2020/21. Similarly, no PWLB interest is attributable to commercial activities in 2020/21, following the withdrawal of the Commercial Property Investment Strategy and the removal of the associated £5m budget (see 2.10.2).

v) Ratio of commercial property to net revenue stream

This indicator demonstrates the extent to which a loss of commercial property income would impact on the Council, ie. it is a measure of the "proportionality" of commercial activity.

Following the withdrawal of the Commercial Property Investment Strategy the outturn for this indicator is **Nil**, which differs to the approved indicator of 1.41%.

vi) Maximum gross debt

The Council must ensure that its gross debt does not, except in the short term, exceed the opening capital financing requirement, plus estimates of any additional CFR for 2020/21 and the following two financial years. This allows flexibility for early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes. Gross debt at 31 March 2021 was **£9.812m** which was well within the approved indicator.

vii) Ratio of internal borrowing to CFR

The Council is currently maintaining an "internal borrowing" position, ie. The underlying borrowing need (CFR) has not yet been fully funded with loan debt as cash supporting the Council's reserves and balances is being used as a temporary measure.

The outturn for internal borrowing is **2%**, which differs to the approved indicator of 26% due to variations in the capital programme, including the deferral of capital schemes to 2021/22 and the removal of the £5m budget for commercial property investment following the withdrawal of the Commercial Property Investment Strategy (see 2.10.2). These variations reduce the outturn CFR, and hence the difference between CFR and actual external borrowing.

(b) Treasury Management Indicators:

The Treasury Management indicators are based on limits, beyond which activities should not pass without management action, and the Council has operated within these limits at all times during 2020/21. They include two key indicators of affordability and four key indicators of prudence and Appendix 2 demonstrates the outturn position compared to each limit.

Affordability

i) Operational boundary for external debt

This is the limit above which external debt is not “normally” expected to pass. In most cases this would be a similar figure to the CFR but may be lower or higher depending on the level of actual debt. The Operational Boundary has not been exceeded during 2020/21.

ii) Authorised limit for external debt

This limit represents a control on the “maximum” level of borrowing and is the statutory limit determined under s3(1) of the Local Government Act 2003. It represents the limit beyond which external debt is prohibited.

The Authorised limit must be set, and revised if necessary, by Full Council. It reflects a level of external debt which, whilst neither desirable nor sustainable in the longer term, could be afforded in the short term. The Government retains an option to control either the total of all Councils’ plans, or a specific Council, although this power has not yet been exercised. The Authorised Limit has not been exceeded during 2020/21.

Prudence

iii) Maximum new principal sums to be invested during 2020/21 for periods in excess of 365 days - such investments are classified as a “non-specified”. This indicator is subject to the overall limit for non-specified investments set annually in the TMSS. The Council made no new non-specified investments during 2020/21, and at 31 March 2021 held only one such investment, namely the £1m investment in the CCLA property fund.

iv) Upper limits for the maturity structure of borrowing are set to reduce the Council’s exposure to large fixed rate sums falling due for refinancing. These limits have not been exceeded in 2020/21.

v) Prior to the 2017 revisions to the Treasury Management Code there was a requirement to set indicators for the Council’s maximum exposure to fixed and variable interest rates for net borrowing (ie. external borrowing less investments). This requirement has now been removed in favour of a statement in the TMSS stating how interest rate exposure is managed and monitored by the Council, and this statement for 2020/21 is reproduced below:

The Council has a general preference for fixed rate borrowing in order to minimise uncertainty and ensure stability in the charge to revenue, however it is acknowledged that in certain circumstances, some variable rate

borrowing may be prudent, for example if interest rates are expected to fall. The Council's investments are generally for cashflow purposes and accordingly a mix of fixed and variable rates will be used to maximise flexibility and liquidity. Interest rate exposure will be managed and monitored on a daily basis by the Chief Financial Officer.

Local indicators for the proportions of fixed and variable rate loans, have been retained by the Council for information purposes.

2.10 Other Issues affecting Treasury Management in 2020/21

2.10.1 IFRS9

Following the consultation undertaken by the Ministry of Housing, Communities and Local Government (MHCLG) on IFRS9 the Government introduced a mandatory statutory override requiring local authorities to reverse out all unrealised fair value movements resulting from pooled investment funds. This will be effective for 5 years from 1 April 2018 to 31 March 2023. The Council is required to disclose the net impact of the unrealised fair value movements in a separate unusable reserve throughout the duration of the override, in order for the Government to keep the override under review and to maintain a form of transparency. This reserve has been named the Pooled Investment Funds Adjustment Account (see 2.8.7 above).

2.10.2 HMT changes to the terms of PWLB borrowing – commercial investment

In recent years there has been a significant rise in commercial property investment by local authorities, generally financed by huge amounts of PWLB borrowing. The level of this indebtedness has become a major concern for HM Treasury and accordingly it undertook a consultation with local authorities with a view to tightening the rules. The outcome of this consultation was published in November 2020 and confirmed beyond doubt that HMT would no longer allow authorities to borrow money from the PWLB to purchase commercial property if the aim is primarily to generate an income stream (ie. debt for yield).

Critically, the restriction is applied on a "whole plan basis", ie. even if an authority intends to buy commercial investment assets primarily for yield at any point in the plan, and to finance them other than by borrowing, the PWLB will not lend to it simply because the item is in the plan.

The Council's approved Commercial Property Investment Strategy was explicit that its key objectives were to acquire property that provided a "net income return", to "maximise returns whilst minimising risk", and to "prioritise properties that yield optimal net income return". It also made

clear that the Council could only undertake commercial property investment if PWLB or other borrowing was used. It was therefore impossible to conclude that anything other than “debt for yield” would be created, and that in the light of the HMT review this would preclude the Council from accessing any PWLB borrowing.

The Commercial Property Investment Strategy was therefore deemed to be no longer viable and Cabinet agreed on 28 January 2021 to withdraw it. The associated £5m budget was removed from the capital programme for 2020/21.

2.10.3 Negative interest rates

During 2020/21 the Bank of England indicated that it would consider negative interest rates, although in practice these were not used. As part of the response to the pandemic and lockdown, the Bank and the Government provided financial markets and businesses with plentiful access to credit, either directly or through commercial banks. In addition, the Government provided large sums of grants to local authorities to help deal with the Covid crisis. This caused many local authorities to have sudden large increases in investment balances searching for an investment counterparty, some of which was only very short-term until those sums could be passed on in the form of business grants etc. The glut of money, was particularly acute towards the end of 2020, and led to some financial entities, including the Debt Management Office, to offer negative yields - or simply close their books to new money until 2021 began.

Money Market Fund (MMF) yields continued to fall and Fund managers resorted to trimming fee levels to ensure that net yields for investors remained positive wherever possible and practical, however at times during 2020/21 the Blackrock fund paid 0%.

Inter-local authority lending and borrowing rates also declined due to the surge in the levels of cash seeking a short-term home at a time when many local authorities were having difficulty in accurately forecasting when disbursements of funds received (for business support grants etc) would occur.

2.10.4 Changes in risk appetite and counterparty limits

The 2018 CIPFA Code and guidance notes have placed enhanced importance on risk management. Where an authority changes its risk appetite, eg. the use of certain investment instruments, this should be brought to Members’ attention.

The Council remains averse to risk with the investment of its surplus cash, and has continued to maintain strict limits on the maximum investment with any one counterparty. The only exception to this is investment with the Debt Management Office, whereby the Council is effectively lending to central government.

No specific changes have been made with regard to risk appetite during the year, and the only changes to counterparty limits are those for CCLA and Santander, both discussed at 2.8.9 above.

2.10.5 Sovereign limits

The UK's sovereign rating was downgraded from AA to AA- in March 2020, reflecting a significant weakening of the UK's public finances caused by the coronavirus pandemic. As discussed at 2.8.1 above the current Treasury Strategy permits the use of any UK counterparties, subject to their individual credit ratings under the LAS methodology. It also permits the use of counterparties from other countries with a minimum sovereign rating of AA.

2.10.6 IFRS16

IFRS 16 is the new accounting standard relating to leases which will bring almost all leases on to the balance sheet, while requiring authorities to recognise a "right of use asset" and a lease liability. In response to pressures on council finance teams as a result of the coronavirus pandemic, implementation of IFRS16 for public services has been further deferred until 1 April 2022, ie for the closure of the 2022/23 accounts.

3 Alternative Options

3.1 An alternative option is to fail to present an Annual Treasury Activity Report, however this would contravene the requirement of the Council's Treasury Management Strategy Statement (TMSS).

4 Financial Implications

4.1 No specific financial implications are attributable to this report.

5 Legal Implications

5.1 The legal implications are detailed in the body of the report.

6 Equalities Implications

6.1 There are no equalities implications arising from this report.

7 Carbon Reduction/Environmental Sustainability Implications

7.1 There are no carbon reduction/environmental sustainability implications arising from this report.

8 Appendices

8.1 Treasury Activity Report 2020/21 for year ended 31 March 2021
8.2 Prudential and Treasury Management Indicators for 2020/21.

9 Background Papers

9.1 None identified.

10 Reasons for Recommendations

10.1 To comply with the requirements of the Council's Treasury Management Strategy Statement.

Statutory Officer approval:

Approved by: Chief Financial Officer

Date: 22 June 2021

Approved by: Monitoring Officer

Date: 23 June 2021